

CITY OF HARRISBURG

Letter of Interest

for Water and Wastewater System Acquisition

September 16, 2019



THE CARLYLE GROUP

VICO

ARUP

CONFIDENTIAL

Pursuant to Pennsylvania Right to Know Law, 65 P.S. § 67.101, et seq.

VIA EMAIL: wsmartin@harrisburgpa.gov

September 16, 2019

Mr. Wayne Martin, City Engineer
City of Harrisburg
Office of City Engineer
123 Walnut Street, Suite 212
Harrisburg, Pennsylvania 17101

REFERENCE: Letter of Interest in relation to a Water and Wastewater Acquisition from the City of Harrisburg (the “Transaction”); Concession Approach.

Dear Mr. Martin,

Pursuant to the Request for Letter of Interest RF-LOI# 2019-01 (the “RFLOI”) issued by the City of Harrisburg and the municipal authority, Capital Regional Water (the “City”), the Interested Team (as defined below) hereby submits this Letter of Interest (“LOI”) in conformity with the terms and conditions set forth in the RFLOI, the provisions of which we accept in their entirety, without reservation or restriction.

Introducing our Team

On behalf of our team members (i) Carlyle Global Infrastructure Opportunity Fund, L.P. (“CGI”), (ii) VICO Infrastructure Company LLC (“VICO”), and (iii) Arup Advisory Inc. (“Arup”) (together, the “Interested Team”), we are pleased to express our interest in the Transaction to the City. For your reference, the key roles and teaming structure within the Interested Team are set out in Appendix A to this LOI.

The Interested Team has an extensive track record of financing, delivering and operating water and wastewater infrastructure in the US. We would be well suited to meet the City’s primary objectives and requirements for the comprehensive management of the City’s Water, Wastewater Treatment Facility, Advanced Wastewater Treatment Facility and Storm Water system assets (the “System”), including generating up-front proceeds for the City, providing best practice operations and maintenance, and ensuring that much-needed capital improvements are funded and delivered in a way that minimizes the impact on ratepayers.

Concession Approach

We understand the City’s objectives set forth in the RFLOI contemplate an outright sale of the City’s assets, including the assumption of liabilities, rather than merely adopting an operate-and-maintain structure in which the City retains liability for long term management and the funding of capital improvements. Based on our past experience in the water and wastewater industries, we believe that there are a number of different transaction structures that could meet this objective, including: (1) an outright asset sale into the regulated market; or (2) a long term, concession-based P3 delivery approach. The latter approach would match the key capital and operating benefits of a full divestment, while also enabling the City to retain ultimate asset ownership, thereby easing resident concerns about privatization and giving the City the option to recover further monetary value from the system via efficiency gain sharing (during the concession term) and the option to re-lease or sell the System after the term has expired.

Leadership and Local Employment Continuity

In addition to the ownership retention benefits to the City, a concession structure enables the City to ensure retention and transition of its current water and wastewater leadership, management and operational staff to the employ of the concessionaire. The Interested Team would be willing to offer employment continuity for the approximately 115 local employees of Capital Region Water. We see this as a “win-win” situation for all parties, in terms of public acceptance for the transaction, individual career development and the ability to retain and take advantage of existing employees’ deep knowledge and experience of the System (which may be lost if an outright sale occurs and an entirely new management and operational team is imported). Further, such a concession structure employing the leadership and management of Capital Region Water should result in lower costs to ratepayers than a contracted operations model as a result of reduced overhead and profit compared with a contract operations entity.

We will be committed to working with the City to ensure that the transition is managed smoothly and all staff members feel well informed throughout the process and are offered attractive employment prospects under the new concessionaire entity. Best practice training and technical skills development are also a core part of the Interested Team’s asset management philosophy and we would offer transferred employees (and any new hires) the full benefit of this approach.

Our Value Proposition

As stated above, the Interested Team believes a concession structure enables the City to achieve all of its objectives, while retaining ownership and control over its assets and the retention of its existing leadership and employees under the employ of the concessionaire. In addition to offering a superior value proposition for the City and its residents, the Interested Team will bring the following core skills and experience to the transaction:

- (a) **Understanding of local issues and customer service focus:** The Interested Team understands the challenging task faced by the City (and Capital Region Water) in balancing competing priorities of (i) responding to federal and state regulatory mandates to reduce rainfall run-off pollution into Chesapeake Bay, (ii) sourcing adequate capital to fund an estimated \$300 million in improvements over the next 20 years, and (iii) minimizing consequential rate increases borne by local residents. Our unique combination of expertise in project delivery, efficient sourcing of capital, and regulatory and community relations would make the Interested Team the ideal private partner for the City in working through these priorities and achieving a good outcome for all. Together as an Interested Team, we know how to work collaboratively and leverage the unique talents of each team member to deliver the best results for communities. We appreciate that local resident satisfaction is a paramount concern for the City administration and therefore will be focused on providing excellent service while adhering to affordable and predictable rate-setting patterns. We are also mindful that City wishes to free up public capital and management time for other initiatives, and would thus aim to operate the System in a smooth and self-sufficient manner.
- (b) **Extensive experience managing water and wastewater facilities:** The members of the Interested Team have successfully delivered on long-term concession and outsourcing arrangements for both the operation and upgrade of existing assets and the development of new water and wastewater infrastructure. The key personnel who will be directly involved in this transaction have significant experience working with a variety of public agencies and municipalities (as set out in the attached resumes) and are therefore well qualified and prepared to work with the City to transition the System in the best possible way. VICO offers extensive national experience on water and wastewater transactions, [REDACTED] having almost 30 years of experience of delivering best practice in the environmental, water and wastewater industries (including the design of over 60 facilities in his former

role of President of PERC Water). This managerial and operational expertise is complemented by the technical know-how of Arup [REDACTED] who have demonstrated their capacity to execute numerous comparable transactions.

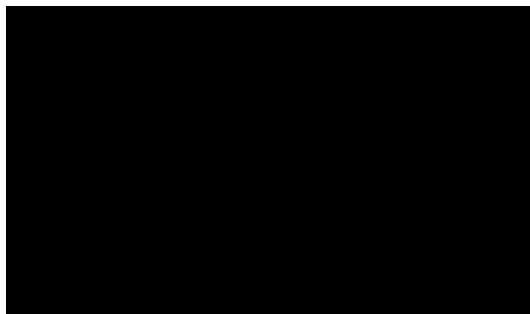
- (c) **Demonstrated ability to finance the upfront payment, operating costs and future capital improvements to the System:** The Interested Team's lead equity investor, CGI, is a leading \$2.2 billion infrastructure fund backed by the Carlyle Group. CGI's team brings the full breadth of Carlyle's industry expertise and global reach to its US infrastructure investing business, and works to become the partner of choice for communities and corporates in upgrading critical economic and essential services infrastructure. In addition, the Carlyle Group has a strong local presence in Pennsylvania. In total, the Carlyle Group has 23 portfolio companies in Pennsylvania that together employ 4,267 people, and has over \$2.7 billion of capital commitments from Pennsylvania-based limited partners. Together with the operational and technical expertise of VICO and Arup (described above), we have formed a talented, experienced and well-capitalized team comprised of best-in-class companies operating in the municipal sewer sector and would value the opportunity to further explore the transaction with you.

Given the concession structure the City and partnering approach with Capital Region Water, we would collaborate with the City and Capital Region Water to develop custom Nine Minimum Controls Plan and retain local consultants with respect to MS4 Applications specific to Pennsylvania per requested Attachments 4 and 5 as listed in the RFLOI. In addition, our team would develop custom Asset Management Reports for the City containing the following key reporting items per requested Attachment 2 of the RFLOI:

- Capital Improvement Plans and Maintenance Reporting
- Energy Management and Reporting
- Lab Information Management System Reports, Water Quality and Effluent Results
- Regulatory Reporting, Permit tracking
- Preventative Maintenance Reports; Maintenance Reserve Accounting Reports
- Biosolids Treatment and Disposal Reports
- SSMP / IPP Reporting, Safety Statistics
- Digital Dashboard of KPI and Performance Results reporting via Tablet to the City

We believe that our expert-driven model, coupled with on-going accountability and preservation of future asset value, can deliver the best outcome for the City and its residents. We look forward to engaging with you further to explore this opportunity. Thank you for your consideration and please feel free to contact us with any questions.

Sincerely,



APPENDIX A: TEAM STRUCTURE

Determining the Optimal Transaction Structure

The Interested Team believes that a concession approach would achieve the best possible outcome for ratepayers, the City, Capital Region Water and its management and staff, and would welcome the opportunity to discuss this with you further by way of an interview. We are mindful that this transaction represents a once-in-a-generation strategic decision for the City, and would therefore be honored to assist in your deliberation process by providing any information and comparators that may assist with your deliberations. As an initial summary, we note that a concession approach has the following benefits:

1. **Greater certainty over System performance and continuing employment of management and operational staff:** Under a concession-based arrangement, the City will retain the ability to hold the Interested Team accountable for System performance and for continuing to support the careers of existing employees of the System (as the Interested Team will be bound by strict contractual covenants which can be enforced by the City throughout the term). In contrast, the City would have no on-going influence or ability to hold a regulated utility purchaser accountable for these matters. This approach is consistent with the Interested Team's business model of generating extra value for all parties by identifying efficiencies within the System (rather than simply by increasing rates).
2. **Flexibility on rates:** Since our proposed concession approach would not require a "regulated utility" approach to be taken, there will be flexibility for us to work collaboratively with the City to develop and tailor a rate structure that meets the needs and priorities of the City and its residents (for example, by spreading out the impact of stormwater capital investments over an acceptable period). We could assist you in gaining public acceptance for the transaction by implementing measures such as rate freezes in the initial years of the concession, special rates for senior citizens and rate stabilization reserve funds (or similar mechanisms to stabilize and manage "rate shock"). We would also be happy to discuss potential efficiency gain sharing regimes that would enable the City to derive on-going financial benefits from the Interested Team's good management of the System.
3. **Efficient cost and risk transfer:** By leveraging a concession method of divestment (via a long term lease structure), the City transfers the bulk of responsibilities, costs and risks associated with the System to the concessionaire, in relation to both day-to-day operations and the funding and delivery of capital improvements. At the same time, the City retains ultimate ownership of the System and will therefore have the opportunity to further monetize the assets in future, either by re-leasing or outright selling the System (upon expiry of the concession term or earlier if the City is not satisfied with outcomes or gets a better offer). As such, the concession model offers the best of both worlds, preserving the public asset base and giving future generations of City administrators the flexibility they need to respond to changing circumstances.

The Interested Team anticipates structuring its involvement in the transaction as indicated in the organizational chart below. We propose that a new special purpose subsidiary of the equity investors CGI and VICO (the "Concessionaire") would contract with the City under a concession agreement or similar arrangement, and will thereby take responsibility for all aspects of the System including (i) operations and maintenance, (ii) capital upgrades as and when required, debt financing, to the extent that any is obtained, and (iii) transition and employment of existing management and staff of Capital Region Water, as applicable.

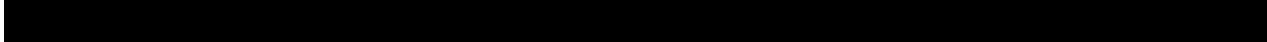


Carlyle Global Infrastructure Opportunity Fund, L.P. – Equity Investor

Founded in 1987, The Carlyle Group is an experienced investor in infrastructure and alternative assets in the US and globally. The firm has invested \$158 billion of equity in more than 1,830 transactions¹ and has built one of the largest private energy investment platforms in the alternative asset management industry. Carlyle currently has 277 portfolio companies² on six continents, employing more than 900,000 people.³

On this Transaction, CGI will be one of two equity investors in the Concessionaire and will be responsible for: (i) the capital funding of the Concessionaire, and (ii) together with VICO, the management and oversight of the Concessionaire.

VICO Infrastructure Company LLC – Equity Investor and Asset Manager

 VICO specializes in the creative development and efficient management of large-scale infrastructure projects

¹ As of June 30, 2019.

² As of June 30, 2019.

³ As of December 31, 2018.

throughout the United States by collaborating with talented people, best-in-class companies and smart technologies. VICO's mission is to combine creativity, knowledge, experience and transparency into every living infrastructure project. CGI and VICO have entered into a long-term partnership through which the firms invest in water infrastructure projects across the United States. The partnership develops and optimizes water, desalination, wastewater treatment and water reuse facilities across the country.

On this Transaction, VICO will be one of two equity investors in the Concessionaire and, together with CGI, will be responsible for the management and oversight of the Concessionaire. VICO will also perform the role of specialist asset manager to Concessionaire, under the terms of an asset management agreement. In this capacity, VICO will provide management oversight of the operations of the assets, including development a long-term capital improvement and lifecycle maintenance planning for the System to be implemented by the Concessionaire. As the Asset Manager, VICO will partner and collaborate with the management and staff transitioned from Capital Region Water.

Arup Advisory Inc. – Principal Technical Advisor

Arup is a global independent engineering, design, planning, project management and consulting services firm with expertise and wide-ranging skills in the water consulting and water engineering sector, spanning advisory and specialist technical services. On this Transaction, Arup will be the Principal Technical Advisor to the Transaction Company, under a technical services agreement. In the project finance sector, Arup is widely recognized as one of the leading technical advisors: for example, receiving the industry award 'IJ Global Award 2018' as North American Technical Advisor of the Year. Arup has advised on many water transactions, including the Rialto Water concession contract in California, where it retains an ongoing role as Lenders Technical Advisor.

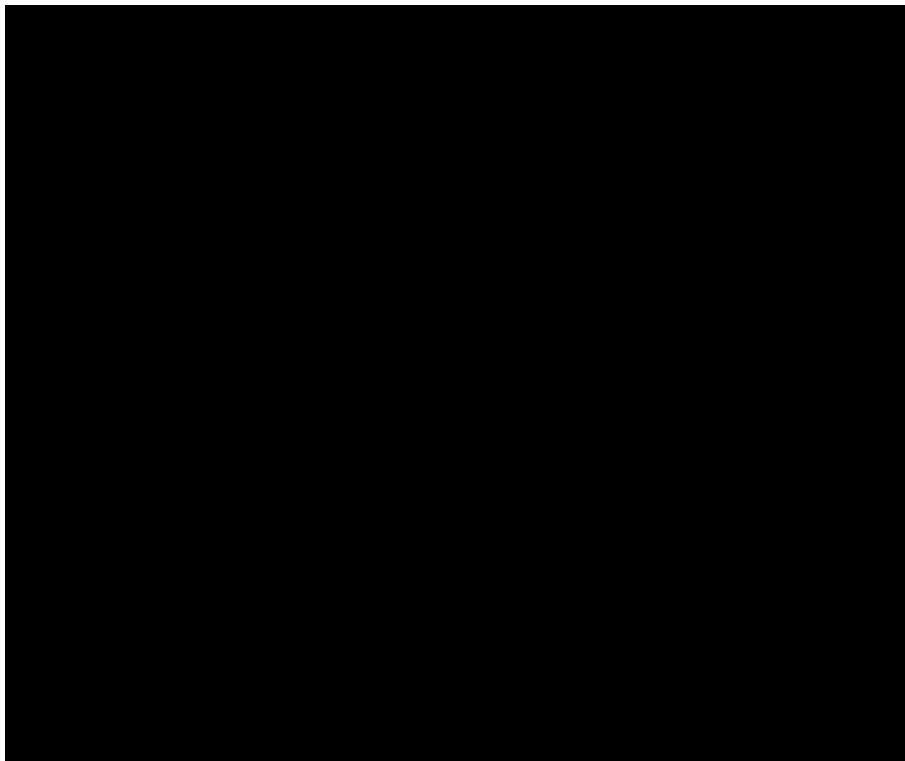
– Financial Advisor

is consistently a top project financing bank worldwide. The North American infrastructure team has structured and provided financing for multiple water projects and water public-private partnerships, as well as provided credit support for municipal debt in the water sector.

– Legal Advisor

is a market leader in P3s, concessions and other infrastructure projects with a strong track record in the utility sector, having recently advised on water and wastewater concession projects in multiple US jurisdictions including Pennsylvania, New Jersey, Louisiana, Illinois and California.

APPENDIX B: REFERENCES



APPENDIX C: FACILITY EXPERIENCE

PART 1 – VICO MANAGEMENT SELECTED EXPERIENCE

Santa Paula Water Recycling Facility P3

The Santa Paula Wastewater Treatment / Water Recycling Facility P3 was a DBFOM project, procured in 2007/08, contracted in 2008 and completed construction / commenced operations in 2010. The Facility was funded 100% by equity and debt, with equity funded by the Alinda Capital Partners Funds. Alinda Capital formed a Project Company (Santa Paula Water LLC) that entered into a 30-year DBFOM / P3 Agreement with the City of Santa Paula. Santa Paula Water LLC entered into a DBO Agreement with PERC Water (which at the time was led by [REDACTED] of VICO), with an operating term of 30-years. The City of Santa Paula, Santa Paula Water LLC and PERC Water negotiated the P3 Agreement / DBO Agreement to deliver the Project for the City to comply with new effluent discharge standards and provide new capacity to meet planned development in the City. The Facility cost was on-budget and the Facility was completed 7-months ahead of schedule. The unique and creative elements of the P3 project included a small-footprint Facility, state-of-the-art treatment technology and a 100% financial commitment by Alinda Capital upon commercial close of the P3 Agreement to deliver the Facility for a specified price by a specified date.

The City achieved its outcome of compliance with the State regulators and completion of a Facility within the financial and pricing terms agreed within the P3 Agreement. The City leveraged low cost bond financing and purchased the Facility from Santa Paula Water LLC in 2015.

Adelanto Water, Wastewater Asset Management and Utility Customer Service

Over the past decade, the City of Adelanto experienced residential growth and expansion increasing their wastewater flow beyond the capacity of their existing treatment facility. This caused the City to be in violation of their existing regulatory permits and forcing them to bypass wastewater flow to a neighboring utility for treatment. This practice was labor intensive and very costly for the City's rate-payers. Under a design/build/operate agreement with the City, PERC Water (at the time led by [REDACTED]) provided an upgrade and expansion to the existing wastewater treatment facility. The upgraded facility has a 4.0 MGD capacity; produces effluent that meets California Title 22 reuse requirements; and treats 100% of the City's wastewater. Additional services include operation and maintenance for the City of Adelanto's Potable Water Treatment and Distribution System and include all day-to-day operational requirements; maintenance repairs; emergency callout 24/7 availability; operation of the ground water wells, water treatment and filtration system (iron, manganese, and arsenic removal), distribution system, meter reading, and water main leak repair. During the term of the contract, the City contracted to operate and manage the City's Utility Billing and Customer Service Department for a period of three years.

Albert Robles Center (ARC) for Water Recycling and Environmental Learning

The Water Replenishment District of Southern California Board of Directors established the Water Independence Now (WIN) initiative to end the District's reliance on imported water for groundwater replenishment. WIN is comprised of a suite of projects including expansions to existing water treatment

facilities, spreading operations, and storm water capture facilities. The largest component of the WIN program is ARC formerly known as the Groundwater Reliability Improvement Project (GRIP). The purpose of ARC is to fully eliminate the current demand for imported water by producing 21,000-acre feet annually from local alternative sources to replenish the Central Basin.

ARC will purify approximately 10,000-acre feet (3.25 billion gallons) of tertiary treated (recycled) water annually to near-distilled levels through an advanced water treatment facility (ultrafiltration, reverse osmosis, and ultraviolet light "UV" disinfection). Purified water from the plant will be conveyed to the San Gabriel Coastal Spreading Grounds for groundwater replenishment via surface spreading and injection into the local groundwater aquifer. Together, with another 11,000-acre feet (3.6 billion gallons) of recycled water, the District will deliver 21,000-acre feet of water to the San Gabriel Coastal Spreading Grounds where it will percolate into the Central Basin. The ARC facility is being built on a 5.2-acre property in the City of Pico Rivera, adjacent to the San Gabriel River, allowing for direct delivery of purified recycled water to an existing pipeline leading into the spreading grounds and includes a 48,000 square foot process building located adjacent to the three-story Administration and Learning Center. The Administration and Learning Center includes community spaces designed to educate the public about water and the groundwater replenishment project.

Pacific Grove Water Recycling Facility

Located at the scenic Monterey Peninsula, the "Local Water Project", Pacific Grove Water Recycling Facility provides non-potable water for irrigating the City of Pacific Grove's 18-hole golf course and cemetery. The City's clear goal was to eliminate potable water dependency for irrigation by building a water recycling facility that would provide a sustainable source of reuse water for irrigation. The Pacific Grove Water Recycling Facility is a milestone for both the City and this area of California as it represents a large step forward in reducing dependency on potable water.

PART 2 – ARUP SELECTED EXPERIENCE

Arup as a firm, [REDACTED] have broad experience working with water, wastewater and storm water systems. A representative example project is described below.

Rialto Water P3, California

In 2010, the City of Rialto entered into a \$300 million Public-Private Partnership (P3) agreement with Rialto Water Services LLC, with the goal of upgrading the city's aging water supply and treatment infrastructure. Located in the Inland Empire, the City of Rialto is one of several Southern California towns that were hit hard by the recession, which has led to deferred maintenance of city assets and a lack of funds for needed capital investment. This transaction was one of the first water P3 projects to be financed using a combination of private placement bonds and private equity.

Due to the complex commercial structure and the detailed technical aspects of the project, Arup was hired to perform technical and commercial due diligence on behalf of the equity investors and the City of Rialto. Arup's integrated team of consultants analysed the technical, commercial and financial aspects of the project, identifying both the strengths and key risks of the deal. The Arup team inspected the assets and ensured that the Capital Improvement Plan (CIP) addressed the key needs of the water supply and wastewater treatment systems. Arup also reviewed key agreements, such as the Concession and O&M Agreements and reviewed the project's Financial Model. Arup's comprehensive due diligence helped the client identify budget shortfalls, potential sources of cost overruns and to modify contract language that did not sufficiently incentivize maintenance best practices. As a result, the contracts were amended to better protect bondholders from these risks. Arup has an on-going role advising on the project on behalf of the lenders.

PART 3 – OTHER WASTEWATER PROJECTS FUNDED WITH PRIVATE CAPITAL

While we have provided a snapshot of the Interested Team’s relevant experience above, our team leadership has also worked on a number of other comparable projects including the following:

- Palm Valley Wastewater Treatment Plant and Water Recycling Facility, Goodyear, Arizona
- SPA-2 and SPA-3 Wastewater Treatment Plants and Water Recycling Facilities, Surprise, Arizona
- Sundance Wastewater Treatment Plant and Water Recycling Facility, Buckeye, Arizona
- Tartesso Wastewater Treatment Plant and Water Recycling Facility, Buckeye, Arizona
- Mountain House Wastewater Treatment Plant and Water Recycling Facility, Tracy, California
- Rialto Water Treatment plant and collection systems concession, California (*Brian Cullen involved with proposer group , in addition to Arup involvement above*)
- New York Economic Development Corporation (NYEDC) (*Arup is advising on the planning, design and construction of green infrastructure developments in Coney Island*)
- Bradley Green Alley, Los Angeles (*Arup advised on the design and implementation of solutions to improve the quality of storm water discharges*)

We would be happy to provide further details in relation to any of the projects mentioned in this Appendix C upon request.

APPENDIX D: KEY PERSONNEL AND MANAGEMENT EXPERIENCE